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Influence of Budget Planning on the Performance of Counties in Kenya

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ABSTRACT
Financial sustainability measures an organization's ability to meet all its resource and financing obligations, whether these funds come from user charges or budget allocations to fulfill its mission and serve its stakeholders over time. Sustainability is also seen as a measure of an organization's ability to fulfill its mission and serve its stakeholders, county residents in the context of this study, over time. The establishment of county governments is a new governance system in Kenya's post-independence era. This is a system, to many Kenyans, that presents an opportunity to address the diversity of local needs, choices and constraints while at the same time it carries the promise of a more equitable system of sustainable economic growth for the whole nation. This can only be achieved if financial sustainability of counties is achieved and sustained over time. The study examined the budget planning as a determinant of financial sustainability of counties in Kenya. The target population of the study was the Forty Seven Counties in Kenya as contained in the Kenyan Constitution and CRA report of 2011. A survey research design was adopted. A combination of probabilistic and non-probabilistic sampling techniques was employed in determining the sample size of the study. Twenty five counties were conveniently selected from which respondents were determined per county using the proportionate population sizes according to CRA (2011). A total of 350 (or 91.14%) of the anticipated 384 respondents participated in this study and data was collected using questionnaires. Data collected was analyzed using the SPSS software. In addition, spreadsheets were also used to supplement the SPSS in areas such as the presentation of results using bar graphs, pie charts and frequency tables. The study revealed that budget planning was an effective strategic tool for achieving financial sustainability and development coordination in the counties and that this is achieved best with strict adherence to budgeting procedures laid out in the PFM Act on 2012. It was also revealed that there was a strong positive relationship between budget planning and a financial sustainability and performance of the counties. The study further revealed that most of the counties had diversified into other revenue streams as financial sustainability strategies for enhanced county performance. The study made two recommendations.
Key Words: Investment, Public Private Partnerships, Diversification, Performance, Financial Sustainability

INTRODUCTION

Financial sustainability measures an organization's ability to meet all its resource and financing obligations, whether these funds come from user charges or budget allocations to fulfill its mission and serve its stakeholders over time. Sustainability should also be seen as a measure of an organization's ability to fulfill its mission and serve its stakeholders, county residents in the context of this study, over time. Sustainability issues are increasingly getting attention within the financial sector. The financial sector of any economy occupies a prominent place in its policy framework, and there is no leeway to bypass it when heading towards a paradigm shift. The conceptual differences between the determinants of financial sustainability and the economic development of a nation are not yet clear (Thompson, 2001). IMF (2013) observed that the sustainability approach to any economy is challenging the economic focus of both the public and private sector governance systems. For instance, the providers of financial services, such as banks, Micro-finance institutions, and intermediaries, increasingly realize that sustainable financial practices in the public and private sectors have a positive potential in the a number of ways: sustainable approaches may save costs, increase revenues, reduce risks, develop human capital and improve access to capital. Further Chalk and Hemming (2000) contends that ignoring the issue of sustainability is increasing exposure to compliance and reputational risks. These approaches converge at the view that sustainability is about engaging with environmental, social and financial opportunities and risks in a systematic way while complying with regulation and voluntary standards as well as observing good practices in ethics and governance.

An economy's financial sustainability has always been a central policy issue, but the recent global financial crisis has forced it to the top of policy agenda world over (IMF, 2013). A global effort followed the 1992 Earth Summit to translate the vision of sustainability into practice. This effort included all stakeholders: governments, multilateral organizations, the private sector, and civil society. However, decades later, there is a big gap between what has been achieved, the initial ambition of 1992, and what needs to be done to offer everybody a life of dignity that emanates from a financially sustainable economy (Krejdl, 2006). According to a New Zealand Auditor General's report of 2013, the sustainability of public sector finances over the medium to long term has become an increasing concern worldwide. The Auditor General argues that this is because pressures on public sector services, revenues, and expenditure have increased and are likely to increase further throughout the 21st century because of existing and new pressures. The Oxford English dictionary of 2014 defines Sustainability as the ability to maintain something at a certain rate or level, for example, sustainable economic growth; and the ability to uphold or defend something, for example, sustainable professional practices or the importance of the concept of generating a surplus to achieve financial sustainability, and its fundamental pillars. The six essential requirements for achieving financial sustainability in an organization are: Long-term Commitment; Leadership; Investment of Time and Money; Business Plan; Effective Management Team and Team Work

The New Zealand Auditor General's report of 2013 looks at public sector financial sustainability as the financial capacity of the public sector to meet its current obligations, to withstand shocks, and to maintain service, debt, and commitment levels at reasonable levels relative to both national expectations and likely future income, while maintaining public confidence. In suggesting this, the auditor identifies that: Financial sustainability is determined as much by public confidence as by financial capacity; Intergenerational equity, that is, that any generation should be fair and reasonable in its use of resources and wealth relative to subsequent generations, is part of the service and fiscal responsibility element; and that equating sustainability with maintaining existing services is unhelpful. A study by PwC (2006) on Australian Local Governments concluded that the most common characteristics of councils typically facing financial sustainability constraints often included; minimal or negative revenue growth; increasing involvement in non-core service provision due to escalating community demands, coupled with a related tendency by some councils to 'step-in' to provide a non-traditional service; a tendency by some councils to run operating deficits creating a need to defer or under spend on renewal of infrastructure, particularly community infrastructure which is often repeated annually creating a backlog; limited access for some councils to strong financial and asset management skills which are critical to identifying sustainability problems, optimizing renewals expenditure and improving revenue streams, and a small proportion of councils also have limited access to rate revenue due to relatively small annual rate increases and a low initial rating base.

Frank & Dluhy (2003) and Mango (2005) observed that financial sustainability of an organization is dependent on a number of factors; prime among them is the organization's prudent savings culture and financial management systems. Financial savings are defined as an accumulation of financial surpluses built up from day one the funds are received in the life of the organization (Davey, 2012). Attaining financial sustainability by any county account is a preferable situation as it; enhances the flexibility of counties to respond to recurrent and new development initiatives and programmes that would in turn positively impact on the quality of life of citizens. Financially sustainable counties would also be in a position to provide sufficient funding of the inevitable unplanned expenses plus leave something for contingencies and/or emergencies. According to Boix (2003), this was the beginning of the concern by ordinary citizens that the peoples' representatives manage their public revenue prudently. A study by Olowononi (2000) observed that the most feasible option of achieving a sustainable financial status by the public sector is through fiscal decentralization and efficient allocation of resources, distribution of national wealth and well prudent spending of the developed new financial sources (Afolabi, 1999). Poor governance is increasingly being cited as one of the most significant factor contributing to poor economic performance in most developing countries. The World Bank has repeatedly argued that poor economic performance in most developing countries, particularly in Sub-Saharan Africa (SSA), is attributed to poor governance (World Bank, 1988). The issue of "good governance" was further amplified by the 1989 World Bank report on SSA when the crisis in the region was termed as a "crisis of governance" (World Bank, 1989).

The finances of local governments depend heavily on intergovernmental transfers, especially from state governments. These intergovernmental transfers are, however, just one element in a complex system of intergovernmental fiscal and regulatory linkages. Local finances depend on the entire national fiscal system, because of the changing roles of Federal, state, and local governments in the provision of social assistance to low-income households (Wildasin, 2009). As cited in Keraro (2014), an empirical study by UNIDO in 2010 observed that governance systems were defined as processes and interactions by which an organization engages and consults with its stakeholders and accounts for its achievements. Governance characterizes how things are decided, including financial sustainability decisions for public sector (SID, 2012). Governance is, thus, a relevant strategic matter for the financial sustainability of counties as it determines how they are directed, administered or controlled (World Bank, 2012). According to Jones, Goodwin and Jones (2005), cited in Keraro (2014), financial sustainability and economic governance is often cited as a justification of devolution. The World Bank (2012) reported that a greater organizational autonomy is linked to an increased sense of financial empowerment and sustainability.

Statement of the Problem

The issue of financial sustainability of counties is not unique to Kenya as other developed system of governance are contending with similar challenges and they have tried to put legal and economic measures in place to respond to this challenge. For instance, according to Watts (2008), Canada, Colombia and the United States assign the right to exploit the fiscal dividend of natural resources to its provinces and states with the aim of promoting their financial sustainability. Watts further observes that other countries are engaged in sharing arrangements between the central and regional governments so as to secure the future of the counties and the country as a whole. According to Artis & Marcellino (2000), sustainable finance is about addressing environmental, social, and governance impacts of financial services. In addition, the sustainability element includes a longer term financial dimension and an institutional governance framework. The concrete meaning of sustainability for the financial sector is an issue of controversial debate and continues to be evolving. According to the World Bank (2012), devolution is seen as a process of giving political autonomy to administrative units that are already in place for among other reasons promote financial sustainability at the grassroots. In the Kenyan context, the devolved governance system carries the promise for a more equitable model of sustainable economic development. The constitution however does not provide a comprehensive framework on how counties can ensure their own financial sustainability considering the huge financial expectations and obligations they are expected to fulfill. The main source of revenue for counties in Kenya is the allocation by the national government as provided for in the Constitution of Kenya, in Article 217. The World Bank (2012) further observes that, in contrast, Kenya's devolution entails creating new political and administrative units without sufficient interrogation of their financial sustainability. The debate on financial sustainability of counties in Kenya is fundamental given its potential in enhancing rapid economic and social development of the country. However, despite the significant efforts made to promote the developed system of governance by empowering counties, the expected impact on financial sustainability has not been realized (Kiringai, 2006). The existence of important natural resources does not guarantee financial sustainability as it is prone to stir political conflict over the sharing of national wealth even where legal entitlements are properly defined as is the case with the past two revenue allocation formulae released by the CRA. Most of the newly created counties lack effective governance structures and strategies necessary to enable them attain the required financial sustainability. Article 203(2) of the 2010 Kenyan constitution stipulates that counties will get a minimum of 15% of total national revenue. As of today, the Kenyan Government adopted a 15% allocation as the amount to distribute to all the counties. This figure has elicited sharp reactions from the County Governors and Senators arguing that such a figure is minimal to sustain the financial obligations of the counties as stipulated in the constitution. Given that the 15% allocation through CRA is meant to be supplementary, with the counties expected to generate the bulk of the income locally for their sustainability, it calls for county leaders to develop strategic initiatives and measures towards ensuring financial sustainability of the counties. This study therefore sought to offer guidance and suggest strategic solutions to the identified challenge by establishing how budget planning determines financial sustainability of counties in Kenya.

Financial Sustainability

An institutional financial sustainability is a goal that all institutions strive to achieve and it is largely used as a measure of good performance. Theoretically, this financial sustainability will enable a firm to cover recurrent or overhead costs and to prioritize our activities so as to accomplish our missions, without undergoing interminable negotiations with donors who may or may not agree with our vision or with our cost percentages (Chalk & Hemming, 2000). Many institutions seek donors that will allow them to set up a trust fund or income-generating opportunities that yield a profit margin above market conditions. The ingenuity and creativity of non-profit organizations has led to the development of many innovative mechanisms. This ability to dream and to persuade others to realize these dreams is one of this sector's principal strengths. Nonetheless, the percentage of organizations that achieve financial sustainability remains very low. This is due not to a lack of creativity or commitment, but rather to the fact that many organizations continue to have a donor-dependent vision.

Budget Planning and the Sustainability of Counties in Kenya

A study by Mugwe (2010) recommended that budgets should be used effectively to achieve organizational coordination and that budgeting and variance analysis can be positive tools, if the accounting information/communication process is functioning appropriately. The study further recommended that governments should employ highly qualified personnel to enhance proper budget planning and budget control. Government's main focus (Muleri, 2001) should be on the funding process, the constraints faced, the legal frameworks and competition among the endless expenditure against the limited revenue resources. The study further recommends that well advanced and current technology should be installed in all the Ministries in Kenya to enhance communication. Proper frameworks need to be implemented to ensure that budget inflexibility does not pose a challenge in the budgeting process. The Ministries need to be politically independent to avoid political interference.

Section 125 of the Public Finance Management Act, 2012 provides the procedure to be followed in the budget making process at the county level as outlined below: development of an integrated development planning process, which includes both long term and medium term planning; Planning for and establishing financial and economic priorities for the county over the medium term; Making an overall estimation of the county government's revenues and expenditure; Adoption of the County Fiscal Strategy Paper; Preparing budget estimates for the county government and submitting estimates to the county assembly; Debate and approval of the budget estimates by the county assembly; Enactment of the appropriation law and any other laws required to implement the county government's budget; Implementation of the county government's budget; Accounting for, and evaluating the county government's budgeted revenues and expenditure.

A study was carried out by Njenga, Omondi and Omete (2014) to determine the impact of financial management reforms on the economic performance of public sector entities in Kenya. The study used the economic unit performance contracting results as the measure of performance, which is in some direct way, is similar to the undertaken study. The main objective of the study was to determine the relationship between financial management reforms and the economic performance of the public sector in Kenya. Three key financial reforms were targeted; budgetary reforms, accounting reforms and auditing reforms in this study. The findings of the study revealed that financial reforms achieved more than half of the intended performance targets over the period under investigation. The results showed that budgetary reforms had the strongest explanatory power on performance indicators at 0.681, followed by accounting reforms at 0.47 and audit reforms at 0.387. The researchers therefore concluded that audit reform does not aid in improving performance of public sector entities while budgetary and accounting reforms are the most effective tools. As explained by the study, the reason for this misnomer could be that civil servants have developed a negative attitude against audit and see it as slowing down delivery of services or that audit is a conduit for corruption. The study concluded that more financial and budgetary reforms should therefore be undertaken for improved results. Audit reforms need to be closely re-evaluated and new approaches employed to yield better results and economic performance.

According to the World Bank (2000), a key aspect of a government's FMR program is the progressive devolution of greater operational authority to managers, balanced by greater accountability for the exercise of that power. Devolution is the placement of power or authority to make decisions on strategies, priorities and resource allocation at the level of the organization that leads to the most cost effective decisions. The aim is to give individual managers greater scope to achieve the policy outcomes sought by each agency and the government overall, while retaining an appropriate level of cohesion, consistency and focus at the whole-of government level. Devolution holds out the prospects of improvement in the allocation and efficient use of public resources, together with more responsive and enhanced service delivery. A key challenge of effective budget devolution in the public sector is finding an appropriate balance between managerial autonomy, management and ministerial accountability, and the need to maintain a certain level of centralised information and decision-making. Successful planning and implementation of county budgets (Mugambi and Theuri, 2014) both in macro and micro terms is critical for the successful performance of counties. Once developed, the county budget must be well managed, monitored and reported to achieve the anticipated outcomes, within three overriding themes; value for money, the efficient and effective delivery of services, and financial compliance, all three acting as overriding performance principles. Kiriria (2013) cited in Mugambi and Theuri (2014) argues that there must be an effective PFM system at the county level to ensure successful management of the public sector and the economy. World Bank (2012) recommends that guidelines and templates need to be developed to guide the formulation of county budgets. More so the World Bank advocate for a country-wide chart of accounts for preparing, executing and reporting the budget. In addition to this, the counties are expected to develop adequate PFM, Human resource and service delivery capacity.

A study by Muriu (2014) noted that governments at sub-national levels are increasingly pursuing participatory mechanisms in a bid to improve governance and service delivery. Muriu adds that Kenya has entrenched public participation in its devolved governance structure based on Constitution of Kenya, 2010 and there is need to look at past experiences for lessons. Muriu further argues that influence of participation is assessed in terms of how it affects efficient allocation of resources; accountability and reduction of corruption; and, equity in service delivery. It finds that the participation of citizens has been minimal and the resulting influence on the decentralized service delivery negligible. It concludes that despite the dismal impact of citizen participation, the first step towards institutionalizing participation has been made upon which current structures of county governments should build on. According to Roth (2011), a primary impediment in state budgeting transformation efforts is the inability to document, optimize, and ultimately automate the entire budgeting process. Instead, Knuth's "premature optimization" often occurs – documenting a portion of the process and then attempting to optimize and automate only that portion. Across the breadth of a transformation effort undertaken in such bite-size pieces, technological stratification, and stage obsolescence can occur, impeding achievement of desired results. Additionally, vendor creep, which can be attributed to opportunistic vendors attempting to increase the scope of a project and their associated revenues, can result from a portioned approach.

Effective end-to-end government budget process design (WB, 2000) takes into account not only the funding levels required to provide for key social programs, but the changes necessary under a variety of different revenue production scenarios. Lack of budgeting flexibility during the financial crisis forced states to attain significant cost savings from public assistance and higher education, precisely the programs that needed bolstering to smooth the path to economic recovery. Process design in public sector budgeting involves multiple change factors in a single transformation program. Historically, government entities have used simple budgeting techniques and timelines – planning by line item and program, and focusing on operating expenditure categories, usually over a single year – an approach that lacks the fiscal agility demanded of state and local governments. Today, the budgeting process should be addressed in its entirety, from forecast and analysis modelling through publishing, score-carding, dash-boarding, and reporting and data management. Process redesign takes into account a broad spectrum of budgeting techniques and the need to manage data inflows and outflows.

As cited in cited in Mugambi and Theiuri (2014), Brookson (2000) explains that a budget model helps one get it right with budgets the first time as well as improves its quality and failure to properly plan and monitor budgets leads to their failure and therefore to avert this, there is a need to write and monitor budgets. In fulfilling this, the PFM Act 2012 stipulates all the processes, policies, the personnel required for preparation and approval of the same budget as well as the conditional ties that need to be met to come up with the budgets. In the same line of thought, organizations that strive to maintain efficiency; effectiveness and equity may become so bound up with rules and forget the human needs (Voigt, 2010). Pierre and Peters (2011) recognizes that for an effective budget the budget must first of all be adopted by a duly constituted authority, and it must be adhered to. The government must avail the information on budgets to the public, which must have been involved in its preparation and despite the fact that revenue is always limited; the available resources must be matched with the expenditure. Availability of a functioning accounting system on the other hand, cannot be emphasized as well as effective auditing system to guarantee an efficient budget preparation process. In the preparation of the national budget, the debate and approval process in parliament is given a lot of emphasis through media coverage, together with the budget reading day which is also graced by the head of state, contrary to other stages of the budget process. The success of the entire budget process is dependent on the success of each and every phase of the budget process (Mwenda and Gachocho, 2003).

RESEARCH METHODOLOGY

This study adopted a survey research design. The population for the study was the 47 Counties identified by the Kenyan Constitution promulgated in 2010. A combination of probabilistic and non-probabilistic sampling techniques was employed in determining the sample size of the study. Stratified sampling was applied to first group the Forty Seven counties into eight geographic regions, equivalent to the defunct eight Kenyan provinces. Twenty five counties were elected from which respondents were determined per county using the proportionate population sizes according to CRA (2011). The study relied on questionnaires and interview methods for primary data collection and in some instances document analysis was used for secondary data.

Descriptive Statistics for Budget Planning

A descriptive statistics table for Budget Planning was generated from the SPSS and presented in Table 2. From the table, a majority (45.5%) of the respondents agreed that county budgets are effective strategic tools for achieving development coordination in their county, 49.2% agreed that the budgeting procedures laid out in the PFM Act on 2012 are followed to the letter in their county, 46.4% agreed that there is a strong positive relationship between budget planning and a financial sustainability and the performance of their county, 39.1% agreed that there is a strong PFM system in their county, 39.7% agreed that budget planning in their county is a participatory exercise, and 38.8% agreed that involvement of the public in the budget planning exercise in their county has significantly helped to prioritize spending of the public resources

Table 2: Descriptive Statistics for Budget Planning

	Strongly Disagree	Disagree	Neutral	Agree	Strongly Agree
County budgets are effective strategic tools for achieving development coordination in my county	1.4%	2.8%	19.3%	45.5%	31.0%
The budgeting procedures laid out in the PFM Act on 2012 are followed to the letter in my county	2.2%	2.2%	18.7%	49.2%	27.7%
There is a strong positive relationship between budget planning and a financial sustainability and the performance of my county	0.8%	3.4%	25.1%	46.4%	24.3%
There is a strong PFM system in my county	1.7%	5.0%	25.7%	39.1%	28.5%
Budget planning in my county is a participatory exercise	2.2%	5.9%	24.3%	39.7%	27.9%
Involvement of the public in the budget planning exercise in my county has significantly helped to prioritize spending of the public resources	3.9%	5.3%	31.0%	38.8%	20.9%

From the finding that a majority (45.5%) of the respondents agreed that county budgets are effective strategic tools for achieving development coordination in their county, this study concurs with the recommendation of Mugwe (2010) that budgets should be used effectively to achieve organizational coordination and that budgeting and variance analysis can be positive tools, if the accounting information/communication process is functioning appropriately. Mugambi and Theuri (2014) emphasized that successful planning and implementation of county budgets both in macro and micro terms is critical for the successful performance of counties. Once developed, the county budget must be well managed, monitored and reported to achieve the anticipated outcomes, within three overriding themes; value for money, the efficient and effective delivery of services, and financial compliance, all three acting as overriding performance principles. On there is a strong PFM system in their county, a majority (39.1%) of the respondents agreed while, another majority (49.2%) agreed that the budgeting procedures laid out in the PFM Act on 2012 are followed to the letter in their county. These findings confirm the argument by Kiriria (2013) that there must be an effective PFM system at the county level to ensure successful management of the public sector and the economy. Generally, most of the statements were responded to with a strong bias to agreeing or affirmative. Therefore, with this findings the research is guided to conclude that budget planning is an element that needs to be taken with a lot of seriousness in the counties, failure to which service delivery and general county performance will be at a greater danger, as is observed by Pierre and Peters (2011) who recognizes that for an effective budget the budget must first of all be adopted by a duly constituted authority, and it must be adhered to.

Linearity between County Performance and Budget Planning

From the curvillinear (Figure 1), a positive linear relationship exists between the dependent (Performance of the County) and independent variable (Budget Planning).

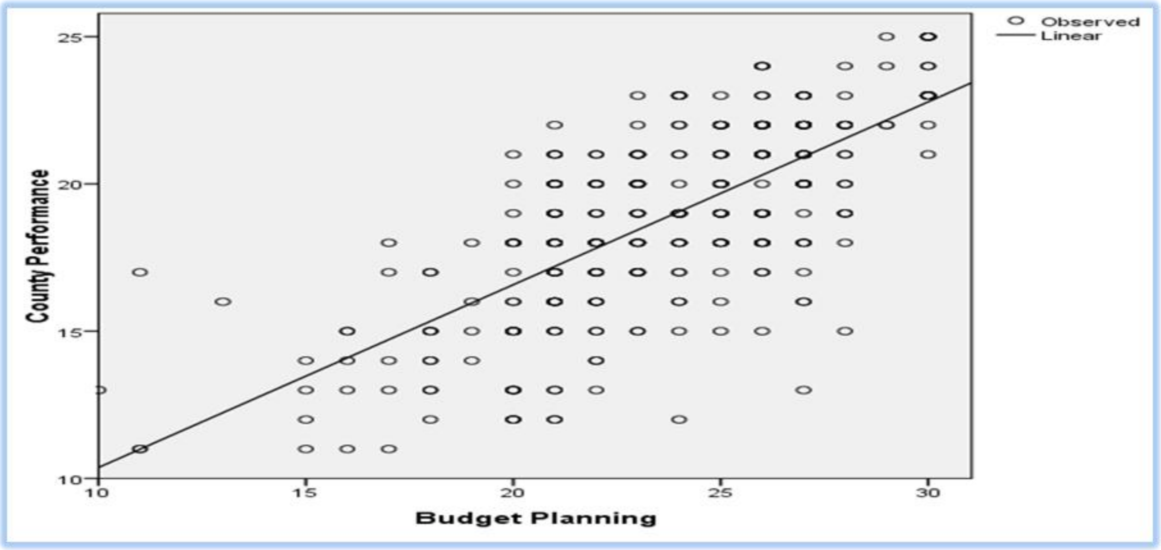

Figure 1: Linearity between County Performance and Budget Planning

Regression Analysis between County Performance and Budget Planning

A regression analysis between County Performance and Budget Planning was carried out and the findings were presented and discussed under this section. From the Model Summary Table 3, 51.1% (R^2) of the total variability in the dependent variable (Performance of the County) can be explained by the independent variable (Budget Planning).

Table 3: Model Summary of County Performance and Budget Planning

Model Summary

Model	R	R Square	Adjusted R Square	Std. Error of the Estimate
1	.715[a]	.511	.510	2.199

a. Predictors: (Constant), Budget Planning

The ANOVA Table 4 shows that the variability in the dependent variable due to the influence that Budget Planning had on it, was statistically significant at p = .000. This further led to the rejection of the null hypothesis that Budget Planning does not have a significant influence on the performance of the county and instead the alternative hypothesis that Budget Planning has significant influence on the performance of the county is accepted.

Table 4: ANOVA of County Performance and Budget Planning

ANOVA[a]

Model		Sum of Squares	df	Mean Square	F	Sig.
1	Regression	1758.075	1	1758.075	363.679	.000[b]
	Residual	1682.282	348	4.834		
	Total	3440.357	349			

a. Dependent Variable: County Performance

b. Predictors: (Constant), Budget Planning

From the Coefficient Table 5, Budget Planning contributes a statistically significant value of .621 for every unit change in performance of the county. Additionally, the regression equation is as presented below;

$Y = \beta_0 + B_5X_5 + \mu$ becomes;

$Y = 4.164 + .621X_5 + \mu$

Table 5: Coefficients of County Performance and Budget Planning

Coefficients[a]

Model		**Unstandardized Coefficients**		**Standardized Coefficients**		
		B	**Std. Error**	**Beta**	**t**	**Sig.**
1	(Constant)	4.164	.774		5.378	.000
	Budget Planning	.621	.033	.715	19.070	.000

a. Dependent Variable: County Performance

CONCLUSION

The study sought to ascertain the influence that budget planning had on the performance of counties in Kenya. The study concluded that county budgets were effective strategic tools for achieving development coordination in the counties; the budgeting procedures laid out in the PFM Act on 2012 were followed to the letter in the counties; that there was a strong positive relationship between budget planning and a financial sustainability and the performance of the counties; there was a strong PFM system in the counties; budget planning in the counties is a participatory exercise, and also that involvement of the public in the budget planning exercise in the counties had significantly helped to prioritize spending of the public resources.

RECOMMENDATION

The study recommends that counties need to have budgets as they are effective strategic tools for achieving development coordination in the counties, and that budget planning is necessary for financial sustainability and the performance of the counties. Further, the study recommends that budget planning in the counties should be a participatory exercise, as the involvement of the public in the budget planning exercise in the counties could significantly help to prioritize spending of the public resources.

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